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RUEHBY/AMEMBASSY CANBERRA 0573
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SUBJECT: DIAMONDS ARE FOREVER - MAYBE - MAYBE NOT

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11. SUMMARY: The Diamonds - Source to Use 2007 Colloquium in Johannesburg offered contrary views on African diamond reserves. Some pundits expect output to increase significantly from West Africa, Botswana, Angola and the DRC, but others foresee a sustained decline in world diamond production. A diamond service company was bullish on African and global opportunities and a De Beers representative was more bearish, expressing skepticism about the potential for discovery of giant primary kimberlite pipe reserves. Both noted that South Africa's production, now third in Africa in quantity and third in the world, was not sustainable. De Beers is scaling back its presence in South Africa and the SAG is aiming to increase beneficiation of its declining diamond production. Minerals-Energy Officer and Specialist attended the Diamond Colloquium on October 25-26. Reftel reported on the Kimberley Process. End Summary.

Bullish View on Diamond Supply from Service Company

12. Speaking at the Southern African Institute of Mining and Metallurgy's (SAIMM) "Diamonds - Source to Use 2007" Conference, MSA Geoservices director and consulting geologist Frieder Reichhardt stated that significant opportunities exist for major alluvial, marine, and kimberlite pipe diamond finds in West and Southern Africa, specifically in Guinea, Sierra Leone, Liberia, Angola, Namibia, the DRC, Zimbabwe and Botswana. He said these countries are located on ancient "cratons", which contain unique geological structures that tend to indicate the presence of rich diamondiferous kimberlite pipes.

13. According to Reichhardt, in the 1960/70s, West Africa collectively accounted for some 200 to 250 million carats, but this had since declined due to political turbulence. This region, as well as Southern Africa, has now achieved a level of stability and "juniors" (small mining companies) were starting to make their mark. Reichhardt said he expected to see a number of new mines starting up in the next few years. He highlighted Angola, where 15 major companies are active. Angola has tremendous diamond potential for both alluvial and kimberlite pipe production and Reichhardt forecast

that Angola's yearly production would exceed 12 million carats by 2010, and as much as 15 million by 2015.

De Beers Cautious on Southern Africa - Peak Diamonds?

¶4. De Beers' official Patrick Bartlett did not share this optimistic view. He did not dispute that there were hundreds of kimberlite formations known and yet to be found in the region - estimated at 700 to 1,000 in Angola alone. However, Bartlett also noted that there had been no major economic finds (that significantly affect global supplies) in sub-Saharan Africa since the early 1970's and that production from major mines worldwide had reached a peak or were in decline. (Comment: This may be true of many mines, but world-class mines such as South Africa's Venetia mine and Botswana's Orapa and Jwaneng mines are still increasing production and will only go underground in the later 2020's. End Comment.) The De Beers official also doubted that many new discoveries would be of the quality of Botswana's and South Africa's mines with a tangible impact on global production. Canada was the one exception, but while their kimberlite pipes were of high quality, they were small in area and had relatively short production lives.

¶5. Bartlett explained that most kimberlite pipes are cone-shaped and decrease in area with depth. For example, the Jwaneng pipe has a surface area of 54 hectares at its surface and indications are that it will taper to an area of 12 hectares at 1,000 meters below surface. He said that many older mines that started out as open pit operations had gone or were planning to go underground and that this would result in decreased production and higher cost per carat produced. Bartlett projected Botswana's annual output to decline by

PRETORIA 00003891 002 OF 003

as much as 50 percent or 16-million carats over the next thirty years as pits went deeper and production moved to underground mining. Botswana mines are not unique in this and Bartlett forecast that the major diamond producers would all lose critical percentages of their production in the move underground.

Historical Perspective of SA Diamonds

¶6. The South African gem-diamond industry has played a major role in the economic and industrial development of the country since significant discoveries in the 1870's. Diamonds provided the initial stimulus for investment in exploration and infrastructure, and largely financed the development of the Witwatersrand gold fields, discovered 15 years later in 1886. Current levels of production are the highest in decades and annual production is more than 14 million carats worth \$1.2 billion, of which nearly 95 percent originates from De Beers mines. This is forecast to decline by two million carats per year over the next decade as mines age and most are now marginal producers nearing the end of their economic lives. Some large open-pit operations in South Africa and Botswana are planning to go underground, and this will further increase costs and curtail production.

Can Synthetic/Cultured Diamonds Fill the Gap?

¶7. There has been some concern that synthetic or "cultured" diamonds (as manufacturers prefer to label these man-made products) would pose a threat to the natural diamond industry. Natural producers have now come to the realization that - for the foreseeable future - demand for their product will continue to outstrip supply. Additionally, the larger gem-quality synthetics are expensive to produce and can only be produced in limited quantities, at least until the industry gears up to increase output. The natural producers now concede that synthetics have a place in the jewelry market, akin to costume jewelry, to cater for less expensive tastes and markets. They are currently negotiating both

name and labeling of synthetics to ensure that consumers know what they are buying. (Comment: South Africa produces some 60 percent of the world's synthetic diamonds - all for industrial applications - where diamond, both synthetic and regular, has considerable competitive advantages because of its many unique properties and characteristics. End Comment.)

South Africa Seeks to Increase Beneficiation

¶8. The South African Government views increased downstream processing (beneficiation) of mineral commodities as central to its objective of capturing more value from mineral commodities, as well as creating skills and employment for the previously disadvantaged population (official unemployment is over 25 percent). This will also have implications for securing a supply of the materials the Qalso have implications for securing a supply of the materials the government sees as strategic to plans for industrial and economic development, such as uranium, platinum, coal, gold, diamonds and titanium. With this in mind, the SAG is in the final stages of drafting a Beneficiation Bill that sets process levels for individual minerals and provides incentives and penalties to push resource companies into further processing their commodities before export. For example, companies that comply will get credits against the asset transfer requirements for Black Economic Empowerment under the Minerals Act and those that do not will pay a higher royalty on the export of unprocessed products.

Diamond and Precious Metals Legislation

¶9. The SAG is aware that diamond (and gold) production is likely to decline. It has therefore introduced legislation aimed at increasing further processing along the diamond-jewelry value chain

PRETORIA 00003891 003 OF 003

to promote industry sustainability. The legislation proposes to facilitate opportunities in downstream ventures such as diamond cutting, polishing, jewelry design and manufacturing by establishing: a Diamond Regulator (replacing the previous Diamond Board) to issue licenses for all diamond-related activities; a State Diamond Trader with responsibility for ensuring local access to suitable diamonds, training, and technology; and a Diamond Export and Exchange Centre to facilitate and monitor the export of diamonds, and to ensure compliance with the Kimberley Process (reftel).

Diamond Cutting and Polishing in South Africa

¶10. World Federation of Diamond Bourses President Ernest Blom said South Africa's cutting and polishing industry is estimated to be the world's fifth largest by value, after India, China, Russia and Israel (and ahead of Belgium, which is declining). Blom noted that there were 157 diamond cutting factories in 2006, employing about 2,500 cutters and consuming \$700 million worth of rough diamonds from both domestic production and imports. Another estimated 1,000 cutters operate micro-businesses in the informal sector. Exports were valued at \$700 million with a further \$100 million stockpiled or sold locally. Blom said a South African cutter (Basil Watermeyer) produced one of the most important text books on diamond cutting and another (Alex Leibowitz) was the original inventor of the automated diamond polishing and bruting machines that revolutionized the industry.

¶11. Conventional wisdom (and economics) has it that the local diamond cutting industry, with its relatively high wage structure, cannot compete with low-wage countries like India and China. Cutting costs per carat in those countries are 10 to 15 percent of those in South Africa. This effectively limits locals to the larger and higher quality stones. The SAG is now challenging this perception and maintains that - with proper training, experience, opportunity, and use of state-of-the-art technology - the local

industry could eventually compete for lower value and smaller stones. However, for the present, the industry - as with most other sectors - is in the throes of a major skills shortage, with concomitant high wages. (Comment: Jewellery Council of South Africa CEO Lourens Mare told Minerals/Energy Officer and Specialist in a later discussion that the local cutting industry would at least double in size if gold and diamonds could be leased at rates similar to those available to competitors such as Italy and the U.S. where bank financed rates are 3 to 5 percent, compared to rates of 14 percent or more in South Africa. End Comment.)

Conference Assessment and Comment

¶12. The "Source to Use" conference offered something for everyone. Geologists debated diamond resource evaluation. Engineers closely followed news that new technology screens and greases were taking Q followed news that new technology screens and greases were taking diamond processing back to traditional methods. There were presentations on marketing in various global markets, plugs for local beneficiation, and pleas for understanding from "cultured" diamond producers. The conference cocktail offered Johannesburg's finest models showing off platinum and diamond jewelry.

¶13. There were opposing views on the future supply of diamonds in general and from South Africa in particular. However, the mood of the conference was generally up-beat. De Beers is focusing on high-return mines and is selling off marginal producers in South Africa, in favor of Angola, the DRC, and Botswana. These are being bought by other miners, many new "juniors", which will continue production on a smaller scale. Nevertheless, the northwest of South Africa remains prospective for large kimberlite pipe discoveries. South Africa's diamond geology is mature, but it will remain a significant producer. End Comment.

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